

## OAK ASSOCIATES, *ltd.*



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### MARKET COMMENTARY

The US stock market rose strongly in the second quarter of 2009, gaining 15.9% as seen by the S&P 500 Index. Oak Associates outperformed the broader market, gaining nearly 20% in the quarter. Strong gains developed after the market rebounded from the depressed valuations reached in early March. High levels of investor pessimism and fears over bankruptcies had pushed equities to a sharp oversold condition. Subsequent better-than-expected news encouraged investors and boosted the stock market.

The second quarter marked the first quarterly gain for the benchmark S&P 500 Index in six quarters. Fallout from the sub-prime crisis in 2008, concerns over the stability of US financial institutions, and exploding Federal debt levels led to fears of another depression, pushing the stock market consistently lower for a year and a half. In the second quarter of 2009, these fears were replaced by more optimistic analysis that suggested things may not be as bad as they appear. Signs of renewed prosperity in emerging markets also propelled international markets higher, supporting the argument that a global recovery is underway.

Within the S&P 500, financials were the best performing industry group, gaining 35%. Their resurgence underscores the prior distain for financials and accentuated their recoil from sharply depressed levels. Consequently, more defensive sectors accounted for the underperforming groups within the S&P Index, with telecom, health care, and utilities lagging the broader market. Overall, a renewed interest in risk developed, benefiting high-growth sectors and higher-risk assets.

At Oak Associates, we believe the question of a global synchronized recovery is a matter of when, not if. From 30,000 feet, the US economy is indeed troubling. Bankruptcies of US auto giants, major financial institutions, and the foundational small-business market are a legitimate concern. Unemployment is rising and likely to push towards 10% or more by year-end. Globally, the US's leading economic role has been shaken. So too, has the model of capitalism.

From 10,000 feet however, the dire economic situation is a little more encouraging. Economic data over the last few months has been 'less bad' than most had feared. On Wall Street, this is good news and the stock market responded accordingly. Stories about 'green-shoots,' or early signs of economic health, have proliferated the media, also boosting the market. The large stimulus packages approved last year are only now working their way through the bureaucracy and into the economy. Loans made across Wall Street to shore up balance sheet and capitalization requirements are also ready to be paid back by several recipients.

From 1,000 feet, the stock market remains the best barometer of economic activity. Despite fears over another depression being rampant early in the quarter, the stock market bottomed and rallied for the remainder of the period. Excessively high levels of investor pessimism and fear often punctuate turning points for the market. Yet whether the recent rise in equities will be sustainable remains unanswered. Unemployment claims, while falling, remain high and State budgets are in trouble. California's cash flow problems are also unresolved and likely to hamper the largest state economy in the country. Despite this, the market's second quarter performance confirms that things are improving, financial stability is returning, and the stimulus/rescue plans are taking effect.

A return to normality can also be seen by the VIX Index. This index measures the stock market's future volatility. After the 2000-2003 recession, the index generally traded between 10 and 20. In 2007, the index broke through 20 and traded in a new range between 15 and 30. Higher volatility was not unusual, given the slowing economic conditions, housing market problems, failing hedge funds and wide moves in energy prices. In September 2008 however, the index broke from this range and skyrocketed to over 80. The huge increase in volatility reflected the enormous uncertainty over the health of Wall Street's financial institutions, bank closures, and collapsing emerging markets. However, nine months past this peak in the VIX, the index recently traded below 30 once again. While elevated, these more normalized levels of volatility bode well for the stock market going forward.

We continue to believe that the US stock market could surprise people in 2009. Economic turning points are often marked by strong returns, and the second quarter of 2009 may indeed prove this again. Admittedly, the economic climate in the US remains challenging, but current valuations and a swifter recovery in international markets should still support higher stock prices for the sectors in which we are invested. Our focus on sectors with strong exposure to international markets, secular growth drivers and demographic trends, reduces the economic repercussions of rising budget deficits, regional economic troubles, and the political agenda domestically. Historically, stock markets are leading indicators for economic growth and we are encouraged by the S&P's second quarter performance. While a summer pause is always a possibility, the dark clouds that accompanied fears of another depression have rescinded with the change in season. Fairer skies are forecast.

Best regards,

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Oak Associates, *ltd.*

